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TAGS: ECON FIND ENRG PREL RS
SUBJECT: RUSSIA: WINTER POWER SHORTAGES EXPECTED

REF: MOSCOW 12261

Classified By: Econ M/C Quanrud by reason 1.4 (b) and (d).

¶1. (C) Summary. Government officials and industry analysts are expecting power shortages in Russia this winter as electricity consumption growth strains the existing power infrastructure. UES Head Chubays has warned GOR officials all year about looming electricity shortfalls. UES is considering incentive schemes to decrease burdens on the power system this winter, such as paying businesses for reducing electricity use during peak hours. In 16 regions, UES officials are also working with authorities to identify

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businesses that may be subjected to power interruptions during capacity shortages. Despite being the largest domestic consumer of gas, UES is also pushing the GOR to raise domestic gas prices to stimulate more longer term supply. In a worst case scenario, unexpected equipment failures and fuel supply disruptions could lead to widespread and prolonged outages throughout the country this winter. End summary.

¶2. (SBU) Last winter, extreme cold weather forced the electricity monopoly, RAO UES, to disrupt power supplies to a number of businesses in Moscow City, St. Petersburg, and Tyumen region. During peak periods, electricity demand in these regions exceeded previously recorded maximums by 24, 10, and 15 percent, respectively. According to UES officials, electricity demand this year grew faster than expected at 4.8 percent - more than double last year's growth.

¶3. (C) UES Head Chubays has been warning GOR officials all year about looming electricity shortfalls. This summer, on the anniversary of the May 2005 Chagino blackout in Moscow when one third of the city was left without electricity for a day, he told the press that large cities faced summer power shortages because of widespread usage of air conditioning equipment. (Comment: According to UES Head of Strategy, Alexey Kachay, summer peak loads are new phenomena in Russia. In the past, UES experienced peak loads only during winter months.) On October 12, Chubays warned that Russia would switch from being a net exporter of electricity to a net importer this winter. While he assured foreign consumers that all supply contracts would be honored, he noted that domestic needs would curtail any increases in foreign power exports.

UES GEARING UP FOR WINTER

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14. (SBU) UES and regional authorities are busy undertaking preparations for the peak winter months. According to Kachay, Chubays chairs an internal task force that meets regularly to trouble shoot and solve potential problems for the upcoming months. UES is also considering incentive schemes to decrease peak load burdens on the power system this winter. Under one plan, UES would pay businesses for reducing electricity use during peak hours. Kachay said that peak hours are usually at ten in the morning and five in the evening. Businesses would receive four to five rubles for every kilowatt hour not used during these periods.

15. (C) As a result of expected shortages, UES has also identified 16 regional power systems that will likely face interruptions and scheduled blackouts this winter. UES officials are working with regional authorities to list businesses that may be subjected to power interruptions in the event of capacity shortages. In addition to the three regions affected last winter, UES has added; Moscow oblast, Leningrad, Komi, Vologda, Kuban, Tuva, Karelia, Dagestan, Sverdlovsk, Perm, Chelyabinsk, Ulyanovsk, Saratov, Nizhnygorod, and Arkhangelsk regions. According to Kachay, rapid economic growth in these regions is driving electricity demand beyond the capacity of their power infrastructure. (Comment: Retail trade in these 16 regions has grown 17 percent on average in the first nine months of 2006, compared to the Federation average of 12 percent, according to official statistics. End comment.)

BEYOND THIS WINTER

16. (C) Chubays has managed to push through key components of his power sector reform this year that could increase investment into upgrading and expanding both the power generating and distribution networks over the next few years. Early this year, he won government approval for additional share offerings for his restructured power companies, the Wholesale Generating Companies (WGC) and the Territorial Generating Companies (TGC) to raise much needed investment capital. According to press reports, UES plans to raise up to \$12 billion over the next two years in public offerings. In November, the first public offering for 14.4 percent of Wholesale Generating Company 5 (WGC-5) raised \$459 million. (see reftel)

17. (C) Despite being the largest domestic consumer of gas, UES is pushing the GOR to raise domestic gas prices to

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stimulate more longer term supply. Press reports indicate that 70 percent of UES's power plants are gas-fueled with another 25 percent powered by coal. Last winter, gas shortages forced UES to switch to fuel oil, or "mazut", which is two-to-three times more expensive than gas. According to Chubays, a domestic price for gas at \$185 per thousand cubic meters (tcm) would still be cheaper than the current cost of fuel oil as a substitute fuel. In early November, Chubays and Gazprom CEO Miller jointly announced their support for increasing domestic gas prices for industrial consumers from \$45 to \$80 tcm next year to meet the growing domestic demand for gas. According to the MEDT's 2007-09 macroeconomic forecast, the Federal Tariff Service is scheduled to increase gas prices for industrial consumers by 15 percent in 2007. (Comment: Government officials and industry experts expect gas prices will increase by more than 15 percent next year. End comment.)

COMMENT

18. (C) A combination of extreme weather, an aging power infrastructure under stress, and fuel shortages will determine the extent of power disruptions in the coming

months. A severe winter this year, in a best case scenario, could lead to controlled blackouts in some of the planned 16 regions. In the worst case, unexpected equipment failures and fuel supply disruptions could lead to widespread and prolonged outages throughout the country. On gas prices, the GOR continues to wrestle over a difficult and sensitive decision. On one hand, higher prices for both gas and electricity are a key component to reform and necessary to attract the private investment into these sectors. On the other hand, the rapid rise of utility prices have been a source of social dissatisfaction in the past and political considerations are likely to take center stage as the election cycle begins next year. President Putin had agreed to convene a government meeting to discuss the issue of higher gas prices, but has twice postponed it. According to the press, the meeting is scheduled to take place November 122. End comment.

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